MINUTES

Financial Accounting Standards Board

To: Board Members

From: Fair Value Option Team
[Cowan (x233) and McGrath (x443)]

Subject: Minutes of the December 20, 2006 Board Meeting: Fair Value Option

Date: December 22, 2006

cc: Bielstein, Smith, MacDonald, Leisenring, Fair Value Option Team, Fair Value Measurements Team, Gabriele, Polley, Swift, Sutay, FASB Intranet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Fair Value Option Phase 1 Redeliberations

Basis for Discussion: Board Memorandums No. 27, dated December 7, 2006; No. 28, dated December 15, 2006; and No. 29, dated December 18, 2006

Length of Discussion: 1:00 p.m. to 2:20 p.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Linsmeier, Seidman, Trott, Young, and Leisenring (IASB)

Board member absent: None

Staff in charge of topic: Wilkins

Other staff at Board table: L. Smith, Lott, Barker, Stevens, C. Smith, McGrath, and Cowan

Outside participants: None

Summary of Decisions Reached:

The Board discussed the scope exception for convertible debt and certain issues related to the following disclosures:

1. Disclosures upon initial adoption
2. Fair value methods and significant assumptions
3. Drivers of changes in fair values
4. Debt issuances
5. Information about loans and other receivables reported at fair value pursuant to the fair value option
6. Difference between fair value carrying amounts and aggregate principal amounts for assets and liabilities.

Disclosures

The Board decided:

Disclosures upon Initial Adoption

1. To require an entity to disclose, by individual line item in the statement of financial position, if applicable, the amounts of any allowances for loan losses that have been removed from the statement of financial position and included in the cumulative-effect adjustment in conjunction with the initial adoption of the final Statement.
2. Not to require an entity to disclose, by individual line item in the statement of financial position, the individual amounts of unamortized deferred costs, fees, premiums, and discounts that have been removed from the statement of financial position and included in the cumulative-effect adjustment in conjunction with the initial adoption of the final Statement.
3. To require separate disclosure of the unrealized net gains and losses (but not gross gains and gross losses) by line item in the statement of financial position as part of the one-time reconciliation disclosing the historical/amortized cost amount for selected assets and liabilities existing at the effective date for which the fair value option has been elected with the corresponding fair value measures as of the date of adoption for those items.
4. To require an entity to disclose, as of the date of adoption, management's basis for its decision to elect the fair value option for an instrument or group of similar instruments. If the fair value option is not elected for all instruments within a group of similar instruments, an entity must disclose its reasons for only partial election. In addition, the entity must provide

sufficient information for users to understand how those groups of similar instruments relate to the assets and liabilities presented in individual line items on the statement of financial position.

Fair Value Methods and Significant Assumptions

5. To withdraw its previous decision to require an entity to disclose its methods and significant assumptions used to estimate the fair value of assets and liabilities for which the fair value option has been elected if the fair value measurement of that asset or liability represents a Level 3 measurement within the fair value hierarchy.

Drivers of Changes in Fair Values

6. Not to require an entity to provide additional detailed information about drivers of changes in fair values (such as specific market-observable inputs) for items for which the fair value option has been elected.

Debt Issuances

7. Not to require an entity to disclose the proceeds received and the date of issuance if the entity has issued debt securities or other notes payable during the period.

Information about Loans and Other Receivables Reported at Fair Value Pursuant to the Fair Value Option

8. Not to modify the scope of its previous decision to require that, for all loans and other receivables for which the fair value option has been elected, an entity disclose the estimated amount of change in fair value of loans and other receivables attributable to changes in instrument-specific credit risk separate from all other changes in fair value.

9. To require an entity to describe how it estimates the change in fair value attributable to changes in instrument-specific credit risk.

10. Not to include a statement in the Basis for Conclusions of the final Statement that clarifies that instrument-specific credit risk should exclude the risk of changes in the credit spread over the risk-free or benchmark rate.

11. To require an entity to disclose its estimate of changes in fair value attributable to changes in instrument-specific credit risk without imposing a "significance threshold" similar to the one provided in the disclosure about significant changes in the fair value of a liability attributable to changes in an entity's own creditworthiness.

12. To modify its previous decisions related to disclosures about loans held for investment. An entity will now be required to disclose the following for all

loans receivable for which the fair value option has been elected, rather than just loans held for investment for which the fair value option has been elected, as of each date for which a statement of financial position is presented:

a. The fair value carrying amount of loans that are 90 days or more past due

b. If the entity's policy is to recognize interest income on an amortized cost basis separately from other changes in fair value, the fair value carrying amount of loans that are in nonaccrual status.

13. To require an entity to disclose, for loans receivable for which the fair value option has been elected and that are 90 days or more past due, in nonaccrual status, or both, the difference between the carrying amounts of those loans and the remaining aggregate principal amounts the entity would be contractually entitled to receive from the issuers of those obligations at maturity (or through the maturity date for any assets whose principal amounts are receivable in installments), if any, as of each date for which a statement of financial position is presented.

14. Not to require an entity to disclose the aggregate principal amounts of loans measured at fair value pursuant to the fair value option that are charged off during each period for which an income statement is presented.

Difference between Fair Value Carrying Amounts and Aggregate Principal Amounts for Assets and Liabilities

15. To modify its previous decision to require an entity to disclose the difference between the carrying amount of any asset or liability reported at fair value due to election of a fair value option and the remaining aggregate principal amount the investor would be contractually entitled to receive from the issuers of the obligations at maturity (or through the maturity date for any assets or liabilities whose principal amounts are receivable or payable in installments), if any, as of each date for which a statement of financial position is presented. That disclosure will now be presented by line item in the statement of financial position and will apply only to (a) long-term loans and other receivables that are reported at fair value due to a fair value election, have a principal amount, and are not subject to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* and (b) long-term debt instruments that are reported at fair value due to a fair value election and have a principal amount.

Scope Exception for Convertible Debt

The Board reconsidered a previous decision to add a scope exception that also would apply to contracts issued or held by the reporting entity that contain an embedded derivative that both (a) is indexed to its own stock and (b) would, on a standalone basis, be classified in shareholders' equity in its statement of financial position. The Board decided not to include that scope exception in the final Statement. The Board decided instead to add a scope exception to the final Statement to prohibit the issuer of convertible debt with beneficial conversion features from electing the fair value option for that contract.

Objectives of Meeting:

The objective of the meeting was for the Board to redeliberate certain issues related to Phase 1 of the FVO project. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

CERTAIN FVO DISCLOSURES

Disclosures upon Initial Adoption

Unamortized Balances and Allowances Written Off upon Initial Adoption

1. Mr. Wilkins stated that the staff recommends adding a requirement to disclose, by individual line item in the statement of financial position, the amounts of unamortized deferred costs, fees, premiums, and discounts as well as any valuation allowance that have been removed from the statement of financial position and included in the cumulative-effect adjustment in conjunction with the initial adoption of the FVO Statement. Mr. Trott stated that he did not agree with the staff's recommendation. He explained that he supports only disclosing the amount of the valuation allowance, if any, that was removed from the statement of financial position upon the initial adoption of the FVO Statement. Mr. Trott stated that the added disclosure recommended by the staff would not provide useful information unless the disclosures related to a static pool. Since that would not be the case, the disclosure could actually be misleading.

2. Ms. Seidman stated that she agreed with Mr. Trott that the disclosure would not provide any predictive value. The Board decided by a vote of six to one (DMY) to require an entity to disclose, by individual line item in the statement of financial position, if applicable, the amounts of any allowances for loan losses that have been removed from the statement of financial position and included in the cumulative-effect adjustment in conjunction with the initial adoption of the final Statement. Mr. Young asserted that some information would be lost by not requiring the disclosure recommended by the staff. Mr. Linsmeier and Ms. Seidman stated that the relevant information would be provided or could be deduced from other information provided by the FVO Statement.

Gross Unrealized Gains and Losses Presented Separately

3. Mr. Wilkins stated that the Board had decided in its previous redeliberations to require a one-time reconciliation of existing items for which the FVO is elected detailing the difference between historical/amortized cost and fair value as of the date of adoption to enable users to understand the detail of the cumulative-effect adjustment to retained earnings. He explained that users recommended that unrealized gross gains and gross losses by line item in the statement of financial position should be disclosed separately in that reconciliation to enable users to understand the extent to which netting of gains and losses occurred at transition. Mr. Wilkins stated that the staff recommends the additional information recommended by users.

4. Mr. Trott stated that he did not agree with the staff's recommendation. The Board decided by a vote of six to one (DMY) to continue to require the reconciliation by line item in the statement of financial

position (that is, gains and losses will be presented net by line item in the statement of financial position).

Reasons for Electing or Partially Electing the FVO at Transition

5. Mr. Wilkins explained that users had requested that the Board require a disclosure of management's basis for its decision to elect the FVO for an instrument or group of similar instruments, and if the FVO is not elected for all instruments within a group of similar instruments, an entity must disclose its reasons for only partial election at the date of adoption since management's basis for its decision at adoption could differ from its basis for its decision to elect the FVO for new instruments prospectively, which will be disclosed at each reporting period. Mr. Wilkins stated that the staff recommends the request of users be required as a disclosure in the FVO Statement. The Board unanimously agreed with the staff's recommendation.

Fair Value Methods and Significant Assumptions

6. Ms. Barker stated that the staff recommends no modification to the Board's previous decision to require an entity to disclose its methods and significant assumptions used to estimate the fair value of assets or liabilities for which the FVO has been elected if the fair value measurement of that asset or liability represents a Level 3 measurement within the fair value hierarchy. The staff notes that this disclosure is required for each period for which an income statement is presented.

7. Ms. Seidman stated that Statement 157 should take care of this without an additional requirement in the FVO Statement. She explained that the staff's recommendation was too broad and too onerous. If this becomes problematic, it should be addressed through

a revision to Statement 157. The Board unanimously agreed with Ms. Seidman.

Drivers of Changes in Fair Values

8. Ms. Barker explained that users requested additional disclosures about what causes changes in fair values (that is, the drivers of those changes) during a reporting period to better assess an entity's quality of earnings. Ms. Barker further explained that such additional disclosures go beyond Statement 157's rollforward requirements for Level 3 measurements to include changes in entity-specific valuation inputs or assumptions used in the valuation model, changes in specific market-observable inputs, if significant, and other changes in fair value and a description of those changes. She stated that the staff recommends no modification to provide additional information about drivers of changes in fair values for items for which the FVO has been elected. The Board unanimously agreed with the staff's recommendation not to modify the FVO Statement for users' suggestion in this area. Mr. Herz noted that he may be inclined to address this topic in a future project. Mr. Linsmeier noted that this should be considered broadly in the financial instruments project.

Debt Issuances

9. Ms. Barker stated that users requested that an entity be required to disclose the proceeds received and the date of issuance if the entity has issued debt securities or other notes payable during the period. The staff recommends that this suggested disclosure not be required. The Board unanimously agreed with the staff's recommendation. Mr. Herz noted that similar information was already available.

Application of the FVO Disclosure Requirements to Statement 115

10. Ms. Barker stated that the staff recommends that investments in securities that are classified in the trading category under Statement 115 be excluded from the scope of the FVO disclosure requirements. The Board decided to revisit this issue at its Board meeting on January 3, 2007. Mr. Linsmeier stated that the Board should consider integrating all disclosures relating to fair value.

Information about Loans and Other Receivables Reported at Fair Value Pursuant to the FVO

Changes in Instrument-Specific Credit Risk

11. Ms. Barker stated the staff recommends the following regarding changes in instrument-specific credit risk:

    a. Not to change the scope of the disclosure requirement the Board previously approved to disclose the estimated amount of change in fair value of loans and other receivables attributable to changes in instrument-specific credit risk separate from all other changes in fair value. That is, the disclosure requirement should be limited to all loans and other receivables for which the FVO has been elected.

    b. A description of how the entity estimates the change in fair value attributable to changes in instrument-specific credit risk.

    c. Including a statement in the Basis for Conclusions that clarifies that instrument-specific credit risk should exclude the risk of changes in the credit spread over the risk-free or benchmark rate.

    d. Disclosure of an estimate of changes in fair value attributable to changes in instrument-specific credit risk without imposing a "significance threshold" similar to the one provided in the disclosure about significant changes in the fair value of a liability attributable to changes in an entity's own creditworthiness.

12. The Board unanimously agreed with the above staff recommendations on (a), (b), and (d). However, all Board members disagreed with the staff's recommendation in item (c) above.

Past Due and Nonaccrual Loan Disclosures

13. Ms. Barker explained that the FVO Cold Review Draft requires an entity to disclose the following with respect to loans held for investment for which the fair value option has been elected as of each date for which a statement of financial position is presented:

    a. The fair value carrying amount of loans held for investment that are 90 days or more past due

    b. If the entity's policy is to recognize interest income on an amortized cost basis separately from other changes in fair value, the fair value carrying amount of loans held for investment that are in nonaccrual status

    c. For loans held for investment that are 90 days or more past due, in nonaccrual status, or both, the difference between the carrying amounts of those loans and the aggregate principal amounts the entity would be contractually entitled to receive from the issuers of those obligations at maturity (or through the maturity date for any assets whose principal amounts are receivable in installments), if any.

14. Ms. Barker stated that in its redeliberations of FVO disclosure requirements, the Board supported the above disclosures in

paragraphs 13(a) and 13(b). Users requested that an entity also be required to disclose the corresponding principal amounts or the difference between the fair value carrying amounts and corresponding principal amounts of past due and nonaccrual loans, described above in paragraph 13(c).

15. She stated that the staff recommended the following:

    a. An entity also be required to disclose the difference between the fair value carrying amounts and corresponding principal amounts of past due and nonaccrual loans

    b. An entity disclose the aggregate principal amounts of loans measured at fair value pursuant to the FVO that are charged off during each period for which an income statement is presented. The staff acknowledges that "fair value charge offs" would not be defined in the same manner as charge-offs under Statements 5 and 114

    c. The past due and nonaccrual loan disclosure requirements apply to all loans for which the FVO has been elected, not just loans held for investment. The staff notes that existing past due and nonaccrual disclosure requirements set forth in AICPA Statement of Position (SOP) 01-6, *Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others*, apply to both loans held for investment and loans held for sale. The staff further notes that broker/dealers with loan trading portfolios are exempted from the requirements of SOP 01-6. One Board member has suggested that the FVO past due and nonaccrual loan disclosures be applied specifically to loans held for sale and loans held for investment rather than to all loans. Thus, an entity with a loan trading portfolio that is not specifically exempted from the scope of SOP 01-6 would not be required to provide the FVO past due and nonaccrual disclosures

d. No revisions to (a) the 90-day past due disclosure period or (b) restricting nonaccrual disclosures to loans in nonaccrual status only when the entity's policy is to recognize interest income on an amortized cost basis.

16. Mr. Trott and Mr. Linsmeier noted that the FVO document already requires an entity to disclose the difference between the fair value and aggregate unpaid principal amount for loans at fair value. The staff noted that the disclosure recommended above in paragraph 15(a) only applies to the subset of past due and nonaccrual loans. Ms. Seidman stated that that level of detail was unnecessary since the information needed to derive it was already available. Mr. Batavick also stated that he disagreed because it was too much information and it added complexity. While Mr. Trott and Ms. Seidman agreed that disclosures of fair value amounts for past due and nonaccrual loans is appropriate, Mr. Trott believed that the difference between the contractual principal and the fair value would also be useful.

17. The Board agreed by a vote of five to two (GJB and LFS) that for loans and receivables for which the FVO has been elected and which are 90 days or more past due, in nonaccrual status, or both, an entity must disclose the difference between the carrying amounts of those loans and the remaining aggregate principal amounts the entity would be contractually entitled to receive from the issuers of those obligations at maturity (or through the maturity date for any assets whose principal amounts are receivable in installments), if any, as of

each date for which a statement of financial position is presented (the staff's recommendation in paragraph 15(a) above).

18. The Board agreed unanimously to change the scope of its previous disclosure requirements related to loans held for investment (the staff's recommendation in paragraph 15(c) above). The Board agreed unanimously that no revisions should be made to (a) the 90-day past due disclosure period or (b) restricting nonaccrual disclosures to loans in nonaccrual status only when the entity's policy is to recognize interest income on an amortized cost basis (the staff's recommendation in paragraph 15(d) above).

19. The Board unanimously disagreed with the staff's recommendation in paragraph 15(b) above to require entities to disclose the aggregate principal amounts of loans measured at fair value pursuant to the FVO that are charged off during each period for which an income statement is presented.

Difference between Fair Value Carrying Amounts and Aggregate Principal Amounts for Assets and Liabilities

20. Ms. Barker stated that Paragraph 17(b) of the FVO Cold Review Draft requires an entity to disclose the following with respect to financial assets and financial liabilities for which the fair value option has been elected as of each date for which a statement of financial position is presented:

    The difference between:

    a. The carrying amount of any asset or liability reported at fair value due to election of a fair value option

    b. The aggregate principal amount the investor would be contractually entitled to receive from the issuers of the obligations at maturity (or through the maturity date for any assets or liabilities whose principal amounts are receivable or payable in installments), if any.

21. Ms. Barker stated that the staff recommends that the Board specify that the disclosure requirement be presented by line item in the statement of financial position.

22. The Board unanimously decided to modify its decision to require an entity to disclose the difference between the carrying amount of any asset or liability reported at fair value due to election of a fair value option and the remaining aggregate principal amount the investor would be contractually entitled to receive from the issuers of the obligations at maturity (or through the maturity date for any assets or liabilities whose principal amounts are receivable or payable in installments), if any, as of each date for which a statement of financial position is presented. Instead the Board decided that the disclosure should be presented by line item in the statement of financial position and would apply only to (a) long-term loans and other receivables that are reported at fair value due to a fair value election, have a principal amount, and are not subject to Statement 115 and (b) long-term debt instruments that are reported at fair value due to a fair value election and have a principal amount.

SCOPE EXCEPTION FOR CONVERTIBLE DEBT

23. Mr. Wilkins stated that at its October 18, 2006 meeting, the Board unanimously agreed to add a scope exception that would also apply to contracts issued or held by the reporting entity that contain an embedded derivative that both (a) is indexed to its own stock and (b) would, on a standalone basis, be classified in shareholders' equity in its statement of financial position.

Conventional Convertible Debt

24. Mr. Wilkins further explained that information now indicates that (a) the criteria in the scope exception can be easily circumvented by issuers desiring the FVO election and (b) the scope exception is inconsistent with Statement 155, under which an election to use fair value is available for most of the conventional convertible debt issued today (which instruments are structured to maximize their tax benefits for the issuer by including an embedded derivative that warrants bifurcation).

25. Mr. Wilkins stated that the staff recommends that the scope exception described above be deleted. The Board agreed with the staff's recommendation by a vote of five (RHH, GJB, GMC, TJL, and EWT) to two (LFS and DMY). Mr. Trott stated that conventional convertible debt and convertible debt with beneficial conversion features are different. He explained that conventional convertible debt with a beneficial conversion feature has a part that is equity under current GAAP and therefore the FVO election should not be available. Mr. Trott further stated that if conventional convertible debt is considered a liability under current GAAP, the FVO Statement and Statement 155 should apply. Mr. Trott said the clearest treatment is to base the decision on the liability and equity distinctions that exist today. Ms. Seidman disagreed with Mr. Trott and stated that she continues to have the view that anything that would be considered equity on a stand-alone basis should not be eligible for the FVO election. Ms. Seidman explained that doing so would prejudge the conclusion in the liabilities and equity project.

Convertible Debt with Beneficial Conversion Features

26. Mr. Wilkins stated that the issuer's accounting for convertible debt with beneficial conversion features under current GAAP (EITF Issues No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments") results in separate accounting in additional paid-in capital (in the shareholders' equity section of the statement of financial position) for the intrinsic value of the embedded beneficial conversion features. A critical issue is whether the issuer should be permitted to elect the FVO for either (a) the entire convertible debt with beneficial conversion features (with no separate accounting in additional paid-in capital) or (b) the remaining liability (which would represent the convertible debt with an at-the-money conversion option).

27. Mr. Wilkins stated that the staff recommends that a scope exception be added to the FVO Statement for Phase 1 to prohibit the issuer of convertible debt with beneficial conversion features from electing the FVO for that contract. He explained that the staff opposes giving reporting entities the free choice whether to disregard the requirement in EITF Issue 98-5 that the intrinsic value for an in-the-money conversion option in convertible debt should be reported in additional paid-in capital. Mr. Wilkins further explained that although the staff believes that the issuer's accounting for the issuance of convertible debt with an in-the-money conversion option would best be addressed in a separate project, the Board can decide in the discussions for Phase 2 of the FVO project whether the issuer's accounting should be addressed in that phase or in another project. The Board agreed with

the staff's recommendation by a vote of five (RHH, GJB, GMC, TJL, and EWT) to two (LFS and DMY).

Follow-up Items:

28. None

General Announcements:

29. None